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EXHIBIT
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An Assessment of Health Coverage Industry Trends and CareFirst's Strategic Response

This paper summarizes our assessment of trends in the Health Coverage industry, and local trends affecting CareFirst and the Mid-Atlantic region. It also assesses one strategic alternative available to CareFirst, including its impact on constituents.

An objective of this assessment is to understand how key constituent groups – such as consumers, communities, employers, providers and hospitals, and brokers – have fared when a local Blue Cross Blue Shield plan goes through changes in its corporate form. We looked at two examples:

- Blue Cross of California and its conversion to for-profit status (the overall health plan now goes by WellPoint Health Networks; however, products in California are still sold under the name Blue Cross of California), which took place in 1993
- Blue Cross Blue Shield of Connecticut, who was acquired by Anthem Blue Cross Blue Shield in 1998, which subsequently converted to for-profit status

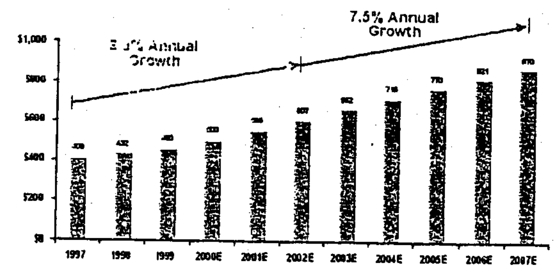
To assess these examples, we conducted interviews, surveys, and focus groups to collect constituent feedback. We also interviewed executives from each health plan and conducted secondary research from state Departments of Insurance and SEC filings, media, and industry analyst reports.

Health plans are being squeezed - rising healthcare costs, state and federal mandates, changing technologies, and increasing customer expectations have narrowed health plan margins, while simultaneously accelerating investment in their base business.

According to government estimates, from 1997 through forecasts for 2002, private healthcare costs have been increasing nationally at an average rate of 8.3%. This trend of rapidly rising healthcare costs is expected to continue over the next few years.

National HealthCare Cost Increases Continue

Private Healthcare Expenditures
(Excluding Research & Construction, $ in Billions)



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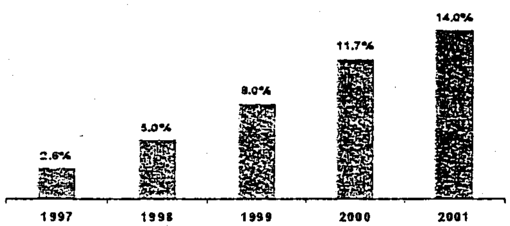
The dramatic rise in healthcare costs has forced many companies to reduce medical benefit offerings and to shift more of the payment burden to employees. Some health plans are exiting federally funded programs as costs increase without corresponding increases in federal funding. Based on filings with the Centers for Medicare and Medicaid Services (CMS), over 900,000 Medicare members needed to enroll with a different health plan in 2001 because health plans chose not to renew their Medicare+Choice contracts, or reduced the geographies they cover.

As a result of cost increases, health plans have been forced to increase premium rates significantly since 1996, with double-digit increases nationally over the past two years.

Premiums Increase In Response to Increased HealthCare Costs

HMO/POS Rates, % Increase In Average Per Employee Premium
(Fully Insured Plans Only)



Source: Credit Suisse First Boston, Benefit Manager Survey, January 30, 2001

To mitigate rising costs, and to respond to innovations and increasing consumer sophistication, health plans are responding by making a series of investments. We estimate the combined cost of these investments for large health plans range from $420 - $640 million, and possibly more, over the next five years. Some of these investments include:

- *HIPAA* – Large health plans are expected to invest $30 - $60 million, on average, over the next several years to comply with HIPAA (in May, 2001, Gartner Group estimated HIPAA costs to be 1 to 2 times health plans' average Y2K expenditures).

- *eCommerce* - Many large health plans are spending $10 - $40 million over several years to acquire and implement new eCommerce technologies, which promise easier service and streamlined operations for members, providers and others. Overall eCommerce investments for larger health plans could be significantly greater.
- *Consumer-focused Initiatives* – One way to mitigate the rise in healthcare costs, and for health plans to become more customer friendly, is to implement services and products that increase consumer choice and flexibility. Some larger plans will invest as much as $20 – $40 million implementing such consumer-focused products and services.

- *Improvements to Operational Systems,* Processes and Assets – Rising healthcare costs have forced health plans to significantly upgrade their basic operations (e.g., computers, communications, software programs, processes, operating procedures, manuals, training, office space, staffing). In fact, many health plans have projects underway to replace and/or consolidate their basic operating systems. On average, plans are spending $30 - $50 million for investments to improve operational systems, processes and assets. Health plans will have an increasing need to modify their businesses to adapt to changes in the market place

- *Participating in Mergers and Acquisitions* – Industry consolidation is affecting nearly all health plans. Many are involved in some type of consolidation activity. We estimate the mergers and acquisitions cash need to be in the range of $330-$450 million. This is based on a review of actual transactions already completed. Specifically, we looked at the average actual cash expended by large health plans for mid-range acquisitions since 1997. We then screened this figure against available merger candidates in CareFirst's home market area to ensure consistency.

Health Plans' Investment Needs Will Be Substantial

Estimated Average Health Plan Investment Needs In the Next 3-5 Years*
(for Large Health Plans with Revenues > $500 Million)

Investment Category	Low	High
HIPAA Health Insurance Portability and Accountability Act	$30	$60
eCommerce	$10	$40
Consumer-focused Initiatives	$20	$40
IT Infrastructure Improvements	$30	$50
Merger and Acquisition Activity**	$330	$450
Other (e.g., merger integration expenditures, partnerships / interconnectivity, potential future regulations, etc.)	Additional	Additional
Total Investment (in Millions)	$420+	$640+

*Estimates based on industry analyst projections and current market conditions; may evolve given new information over time

** Estimated based on the average actual cash expended on mid-range health plan acquisitions since 1997, screened against available merger candidates in CareFirst's markets

Source: Gartner Research, 2000 Payer IT Budget and Staffing Survey, August 14, 2001; Gartner Research, 2000 IT Spending and Staffing Survey, October 2, 2000, SEC Filings; Company press releases; Merger news articles; Accenture analysis, surveys and client experience

To further complicate the financial picture, the National Association of Insurance Commissioners (NAIC) has put in place a more rigorous methodology for calculating risk-based capital levels. As a result, reserve requirements for health plans have increased, thereby restricting the use of health plans' existing capital. As noted in a report last spring by Conning & Company, a leading firm that monitors trends and activity in the insurance industry:

> "The attention to health plans' capital levels, stimulated by an NAIC-led effort to develop a consistent, rigorous national methodology for calculating plans' capital adequacy, has put many nonprofit plans in awkward position...These new, mostly higher expectations for capital adequacy, we believe, have led to a tendency among the nonprofit Blues plans to hoard capital, even though the competitive environment usually rewards ongoing capital investments in areas like computer technology. The concern is that, without access to the capital markets to raise additional capital, many plans may be hoarding capital and under-investing in new technologies and in other strategic areas."

Two popular techniques health plans are using to fight the squeeze include expansion to gain scale economies, and accessing the public equity markets. These strategies can make operations more efficient, and better enable health plans to make the significant investments described earlier in this paper. Combined, these actions could put health plans on a "virtuous cycle" for ongoing growth.

Increasing a health plan's member base can drive scale economies–expenditures can be spread across more members, and more funds are generated to make the investments described above. Increased scale can also help stabilize earnings, enabling health plans to withstand downturns in individual segments of their businesses.

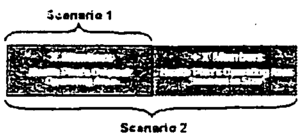
- Anthem Blue Cross Blue Shield of Connecticut has saved millions of dollars due to economies of scale, reducing its administrative cost ratio from 21% to 13% in three years. To achieve this improvement, Anthem has made many changes to its business. Some of the cost reductions include:
  - Materials and services procurement costs - $2.5 million in annual expenditures was saved by negotiating broader contracts for copiers and paper; other supplier contracts yielded similar benefits
  - Data center costs – Over $10 million annually has been saved through management of data center costs across the Anthem organization
  - Transaction outsourcing – Approximately $5 million in annual costs have been saved by negotiating better discounts for outsourced transaction processing based on higher business volumes

- From the WellPoint Health Networks' (parent company of Blue Cross of California) 2000 Annual Report: "The administrative expense ratio decreased to 14.0% for the year ended December 31, 2000 from 14.7% for the year ended December 31, 1999 [added note: down from 16.3% in '94]. The overall decline is primarily attributable to savings from the integration of information systems centers related to acquired businesses on the Company's information systems platform, a reduction in Year 2000 remediation expense from 1999 levels, economies of scale associated with premium revenue growth in relation to fixed corporate administrative expenses in addition to technology investments made by the Company (e.g., electronic claims submission, internet self-service and interactive voice response)."
  - A WellPoint Senior Vice President estimated that due to WellPoint's consolidation of system platforms, WellPoint could realize savings in HIPAA expenditures of $30 – $50 million per plan.

- A major Blue Cross Blue Shield plan (with more than 6 million members) – realized economies of scale after systems were consolidated. It reduced processing costs by 25% per claim transaction and 25% per customer service transaction.

Increased scale can also help stabilize a health plan's earnings, since a larger base of business enables a plan to better withstand downturns in individual segments of its business.

How Increasing Scale Stabilizes Income

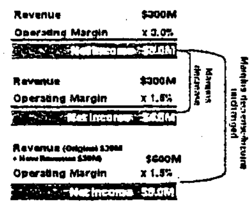


ILLUSTRATIVE

Scenario 1
A health plan earns a 3.0% profit margin on $300M in revenue. The plan makes $9M in net income.

A health plan's margin decreases by 50% to a 1.5% profit margin on $300M in Revenue. The plan makes 50% less in net income.

Scenario 2
A health plan's margin decreases by 50% to a 1.5% profit margin. However, if the plan is able to double its member base, it will earn $9M in net income.



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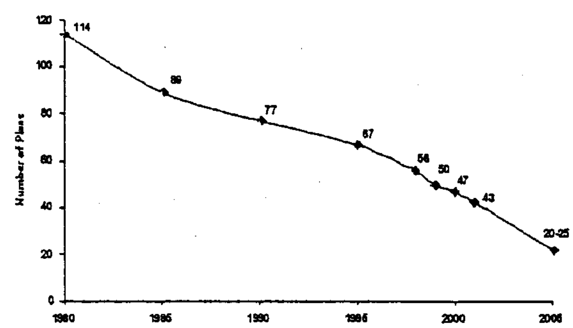
Many plans have gained scale by acquiring other, generally smaller, health plans. This is evidenced by the large number of health plan combinations over the past 10 years, and the unprecedented reduction in the number of Blue Cross Blue Shield plans – from 114 to 43 – over the past 20 years.

Blue Cross Blue Shield Consolidation

Number of Blue Cross and/or Blue Shield Plans by Year



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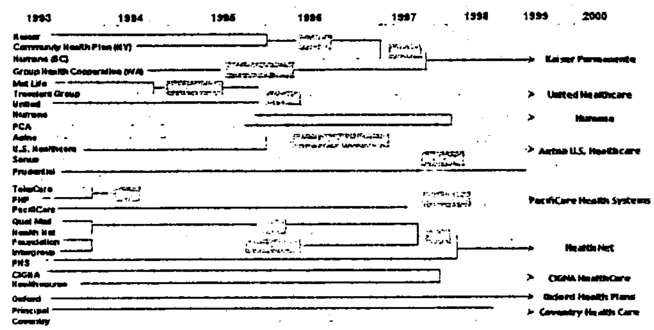
Health Plan Consolidation

Non-BCBS Health Plan Consolidation



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Health Plan Consolidation, cont.

Examples of Recent Non-BCBS Health Plan Merger Activity

Year	Health Plan Activity
1999	• Health Risk Management, Inc. completed its purchase of Oxford Health Plans of Pennsylvania, Inc. and renamed the plan HRM Health Plans, Inc.
	• Health Net, Inc. (formerly Foundation Health Systems) sold its plans in Texas, Oklahoma and Louisiana to AmCareCo Inc., the parent company of AmCare Health Plans
	• Aetna U.S. Healthcare began offering an HMO and point-of-service plan in the Raleigh-Durham area North Carolina
	• Kaiser Permanente Northeast Division closed effective December 31, 1999 after operations in Connecticut, Massachusetts, New York, North Carolina and Vermont were all sold
	• HealthCare America Plans, Inc. (KS) was acquired by Coventry Health Care of Kansas, Inc. - Wichita
2000	• Harris Methodist Health Plan (TX) was acquired by PacifiCare Health Systems
	• United Healthcare exited the Pacific Northwest and transitioned its members to Premera Blue Cross in Washington and LifeWise in Oregon
	• Coventry Health Care, Inc. completed its acquisition of Maxicare Louisiana, Inc.
	• Coventry Health Care, Inc. completed its acquisition of WellPath Community Health Plans, the managed care subsidiary of Duke University Health System
2001	• Group Health Plan (MO), a subsidiary of Coventry Health Care, Inc., acquired the commercial membership of Health Partners of the Midwest
	• Coventry Health Care of Kansas, Inc. signed a definitive agreement to acquire Kaiser Foundation Health Plan of Kansas City

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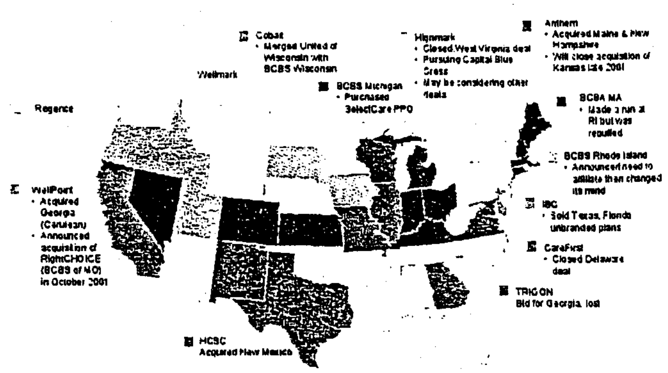
Blue Cross Blue Shield Consolidation

Blues Consolidation



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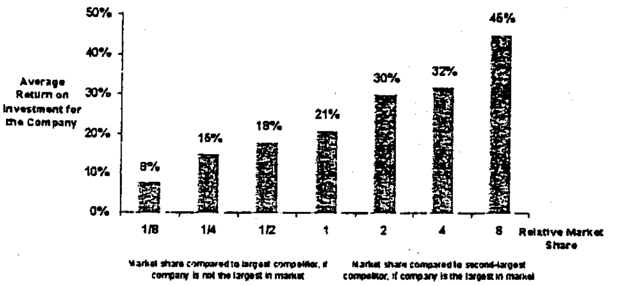
When a health plan acquires another health plan that competes in the same market, there is potential for an additional advantage. Studies have shown that companies across industries perform better if they are able to maintain a strong market share relative to their competition (relative market share):

Cross-Industry Impact of Relative Market Share on Returns

Return on Investment versus Relative Market Share

(relative market share = market share of the company divided by the market of the largest or next largest company in market)



Source: Accenture Analysis, PIMS (Profit Impact of Market Strategies), based on 5000 strategic business units across a variety of industries

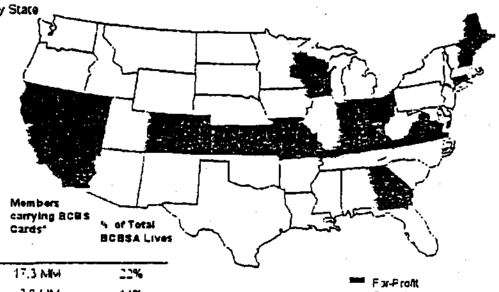
As the health insurance industry consolidates, this phenomenon also presents a threat to health plans' competitiveness. A health plan's relative market share diminishes as the health plans with which it directly competes (those in its current markets, as opposed to those in adjacent or remote markets) consolidate. If it wishes to protect its relative market share in home markets, a health plan needs to participate in the consolidation. It needs to act when local, direct competitor health plans come up for sale. Of course, doing so requires capital.

Some health plans are increasing access to capital by accessing public equity markets. A common way to do this is to convert from not-for-profit to for-profit status, and then raising funds through the public equity markets. There has been a wave of such conversions, .imarily among Blue Cross Blue Shield plans, with more contemplated. About 79 million Americans carry Blue Cross Blue Shield cards. Approximately one third of those are members of Blue Cross Blue Shield plans that are either for-profit plans or are considering a for-profit conversion.

Many Blue Cross Blue Shield Plans Converting to For-Profit

Blue Cross Blue Shield Plan Planned and Actual

Conversions by State



	Members carrying BCBS Cards*	% of Total BCBSA Lives
For-Profit Plans	17.3 MM	22%
[illegible]	3.3 MM	11%
Total	[illegible] MM	33%

*Blue Branded Members only

Source: Health Plan public information; BCBSA Enrollment Data as of 6/30/01

The objective for taking these actions is to establish a "virtuous cycle": increased scale and access to capital drives cost reduction and investment in service improvements. These, in turn, increase a plan's attractiveness to members and employers, which in turn attracts new customers, further increasing scale, and so on.

How Growth and Targeted Investments Can Build Off Each Other

A "Virtuous Cycle" for Health Plans

Gain Scale

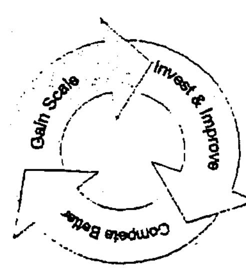
Increase member base

- Increase revenues
- Position health plan for increased investment

Compete Better

Use advantages to enhance competitive position, e.g.:

- Reduced rates, or lower rate increases, due to lower operating costs
- Improved and/or differentiated services



Invest and Improve

Exploit the advantages available through increased scale

- Reduce operating costs by aggressively pursuing economies of scale – e.g. integrating core systems and operations
- Invest more in innovative and/or differentiating services and products – e.g. eCommerce, consumer focused initiatives, improved operations